

# Chapter 1

## Managerial Accounting and the Business Environment

### Solutions to Questions

**1-1** Managerial accounting is concerned with providing information to managers for use within the organization. Financial accounting is concerned with providing information to stockholders, creditors, and others outside of the organization.

**1-2** Essentially, managers carry out three major activities in an organization: planning, directing and motivating, and controlling. All three activities involve decision making.

**1-3** The Planning and Control Cycle involves formulating plans, implementing plans, measuring performance, and evaluating differences between planned and actual performance.

**1-4** A line position is directly related to the achievement of the basic objectives of the organization. A staff position is not directly related to the achievement of those objectives; rather, it is supportive, providing services and assistance to other parts of the organization.

**1-5** In contrast to financial accounting, managerial accounting: (1) focuses on the needs of the manager; (2) places more emphasis on the future; (3) emphasizes relevance and flexibility, rather than precision; (4) emphasizes the segments of an organization; (5) is not governed by GAAP; and (6) is not mandatory.

**1-6** A number of benefits accrue from reduced setup time. First, reduced setup time allows a company to produce in smaller batches, which in turn reduces the level of inventories. Second, reduced setup time allows a company to spend more time producing goods and less time getting ready to produce. Third, the ability to rapidly change

from making one product to making another allows the company to respond more quickly to customers. Finally, smaller batches make it easier to spot manufacturing problems before they result in a large number of defective units.

**1-7** The main benefits of a successful JIT system are reductions in: (1) funds tied up in inventories; (2) space requirements; (3) throughput time; and (4) defects.

**1-8** TQM generally approaches improvement in a series of small steps that are planned and implemented by teams of front-line workers. Process Reengineering involves completely redesigning business processes from the ground up—often with the use of outside consultants.

**1-9** If Process Reengineering is successful, fewer workers are needed. If management responds by laying off workers, morale will almost certainly suffer.

**1-10** Some benefits from improvement efforts come from cost reductions, but the primary benefit is often an increase in capacity. At non-constraints, increases in capacity just add to the already-existing excess capacity. Therefore, improvement efforts should ordinarily focus on the constraint.

**1-11** If people generally did not act ethically in business, no one would trust anyone else and people would be reluctant to enter into business transactions. The result would be less funds raised in capital markets, fewer goods and services available for sale, lower quality, and higher prices.

**Exercise 1-1** (10 minutes)

1. Line
2. Directing and motivating
3. Budgets
4. Planning
5. Staff
6. Decentralization
7. Precision; Nonmonetary data
8. Managerial accounting; Financial accounting
9. Feedback
10. Controller
11. Performance report
12. Chief Financial Officer

**Exercise 1-2 (10 minutes)**

1. Total quality management; Process reengineering
2. Just-In-Time
3. Nonconstraint
4. Benchmarking
5. Setup
6. Constraint
7. Non-value-added activities
8. Business process

### **Exercise 1-3** (15 minutes)

If cashiers routinely shortchanged customers whenever the opportunity presented itself, most of us would be careful to count our change before leaving the counter. Imagine what effect this would have on the line at your favorite fast-food restaurant. How would you like to wait in line while each and every customer laboriously counts out his or her change? Additionally, if you can't trust the cashiers to give honest change, can you trust the cooks to take the time to follow health precautions such as washing their hands? If you can't trust anyone at the restaurant would you even want to eat out?

Generally, when we buy goods and services in the free market, we assume we are buying from people who have a certain level of ethical standards. If we could not trust people to maintain those standards, we would be reluctant to buy. The net result of widespread dishonesty would be a shrunken economy with a lower growth rate and fewer goods and services for sale at a lower overall level of quality.

**Problem 1-4** (30 minutes)

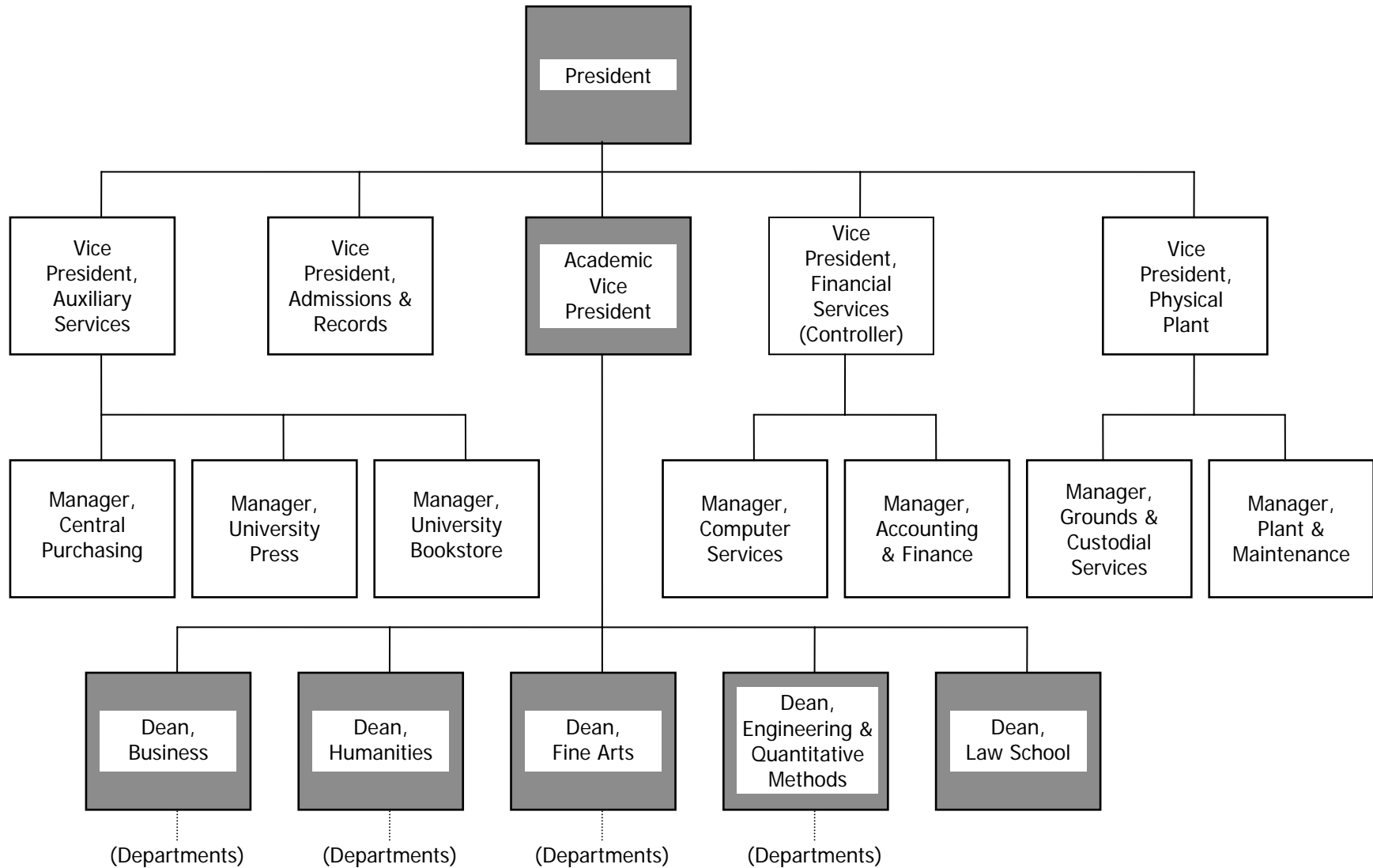
1. See the organization chart on the following page.
2. Line positions include the university president, academic vice-president, the deans of the four colleges, and the dean of the law school. In addition, the department heads (as well as the faculty) are in line positions. The reason is that their positions are directly related to the basic purpose of the university, which is education. (Line positions are shaded on the organization chart.)

All other positions on the organization chart are staff positions. The reason is that these positions are indirectly related to the educational process, and exist only to provide service or support to the line positions.

3. All positions would have need for accounting information of some type. For example, the manager of central purchasing would need to know the level of current inventories and budgeted allowances in various areas before doing any purchasing; the vice-president for admissions and records would need to know the status of scholarship funds as students are admitted to the university; the dean of the business college would need to know his/her budget allowances in various areas, as well as information on cost per student credit hour; and so forth.

**Problem 1-4 (continued)**

1. Organization chart:



## **Problem 1-5 (20 minutes)**

1. Failure to report the obsolete nature of the inventory would violate the Standards of Ethical Conduct as follows:

### **Competence**

- Perform duties in accordance with relevant technical standards.
- Prepare complete reports using reliable information.
- By failing to write down the value of the obsolete inventory, Perlman would not be preparing a complete report using reliable information. In addition, generally accepted accounting principles (GAAP) require the write-down of obsolete inventory.

### **Integrity**

- Avoid conflicts of interest.
- Refrain from activities that prejudice the ability to perform duties ethically.
- Refrain from subverting the legitimate goals of the organization.
- Refrain from discrediting the profession.

Members of the management team, of which Perlman is a part, are responsible for both operations and recording the results of operations. Since the team will benefit from a bonus, increasing earnings by ignoring the obsolete inventory is clearly a conflict of interest. Perlman would also be concealing unfavorable information and subverting the goals of the organization. Furthermore, such behavior is a discredit to the profession.

## Problem 1-5 (continued)

### Objectivity

- Communicate information fairly and objectively.
- Disclose all relevant information.
- Hiding the obsolete inventory impairs the objectivity and relevance of financial statements.

(Unofficial CMA solution)

2. As discussed above, the ethical course of action would be for Perlman to insist on writing down the obsolete inventory. This would not, however, be an easy thing to do. Apart from adversely affecting her own compensation, the ethical action may anger her colleagues and make her very unpopular. Taking the ethical action would require considerable courage and self-assurance.



### Problem 1-6 (30 minutes)

1. Line authority is directly related to the achievement of an organization's basic objectives. Line managers have formal authority to direct operations.

Staff assists line management in the achievement of an organization's basic objectives. Persons with staff authority provide support services. Staff managers typically have advisory authority because of their particular expertise.

2. Mark Johnson's responsibility for maintaining the production schedule involves line authority. Johnson would be directly concerned with meeting the company's primary objective of producing metal parts.

Johnson's responsibility to consult with production supervisors is a staff role because he apparently cannot order changes in those consultations, only advise. Johnson's supervision of new alloy testing and his role regarding the use of new alloys in product development is basically a staff function as well. He has limited authority regarding the use of new alloys because his authority applies only to product development and not to production.

3. Mark Johnson may experience several conflicts because he has been given both line and staff authority.

First, Johnson may initially find it difficult to communicate with the production supervisors because he operates out of a staff position.

Second, a conflict could easily develop if the supervisors lacked a clear understanding of Johnson's responsibilities and authorities. The supervisors could resent apparent staff interference and refuse to discuss their problems with Johnson, making the meetings fruitless. The supervisors working on the new contract may fail to perceive Johnson's line authority and refuse to follow his orders.

Third, Johnson might have difficulty in understanding the nature of his position and job. Johnson might also find it difficult to distinguish between his staff capacity and line capacity. For instance, Johnson might have difficulty in remaining objective if any production problems develop in the alloys he tested.

(Unofficial CMA Solution, adapted)

**Problem 1-7** (20 minutes)

1. If all automotive service shops routinely tried to sell parts and services to customers that they didn't really need, most customers would eventually figure this out. They would then be reluctant to accept the word of the service representative that a particular problem needs to be corrected—even when a real problem exists. Either the work would not be done, or customers would learn to diagnose and repair problems themselves, or customers would hire an independent expert to verify that the work is really needed. All three of these alternatives impose costs and hassles on customers.
2. As argued above, if customers could not trust their service representatives, they would be reluctant to follow the service representative's advice. They would be inclined not to authorize work even when it is really necessary. And, more customers would learn to do automotive repairs and maintenance themselves. Moreover, customers would be unwilling to pay as much for work that is done since customers would have reason to believe that the work may be unnecessary. These two effects would reduce demand for automotive repair services. The reduced demand would reduce employment in the industry and would lead to lower overall profits.

## Problem 1-8 (30 minutes)

1. No, Charlie would not be justified in ignoring the situation. First, the *Standards of Ethical Conduct for Management Accountants* states that the management accountant must "Avoid actual or apparent conflicts of interest and advise all appropriate parties of any potential conflict." If J.B. insists on continuing the relationship with A-1, Charlie has a responsibility to advise both the corporate counsel and WIW's Board of Directors.

Second, as the company's controller, Charlie has a responsibility to ensure that the JIT approach is properly implemented. From the data given in the problem, it does not appear that A-1 Warehouse Sales is the best or most dependable supplier available. Orders are late and not complete, and there is no way to ensure proper quality since nearly all orders are shipped directly from the manufacturer. The present arrangement with A-1 negates most of the benefits that can accrue from JIT.

Charlie's first step should be to verify the accuracy of his information. He states that A-1's markup is 30%, but he does not indicate how he obtained this figure. Also, the adverse financial impact on WIW is dependent in part on the price it would have to pay directly to the manufacturers as compared to the price being paid to A-1. That is, can WIW purchase directly from the manufacturers for the same price as given to jobbers, who handle huge volumes of goods? If not, then the adverse financial impact of buying through A-1 may, in fact, be very small, since WIW may have to pay about the same price either way.

Charlie's second step should be to discuss the potential legal ramifications on a confidential basis with WIW's corporate counsel. Before meeting with the corporate counsel, Charlie may wish to discretely determine if Tony, the purchasing agent, and J.B., the president, worked together in their prior employment. (Remember that both have been with WIW for five years.) Armed with the information obtained from the discussion with counsel, Charlie should review the situation again with J.B., explaining more directly his concerns about the apparent conflict of interest and ask that the Board of Directors approve the continued use of A-1 as a supplier.

### **Problem 1-8** (continued)

If J.B. refuses to follow this course of action, Charlie's only alternative is to submit a memorandum to the Board of Directors. J.B. should be notified of this action in advance. The memorandum should present only the facts. If the Board approves the continued relationship with A-1, Charlie may possibly conclude that his concerns about an apparent conflict of interest do not represent an actual conflict. This presumes that legal counsel has advised the Board that the arrangement with A-1 does not violate any laws and that the company has made adequate disclosures in its public filings. Only Charlie can make the decision as to whether or not he can continue at WIW under these circumstances.

## **Group Exercise 1-9**

Students' answers will depend on the specific experiences they had while working.